FIRST QUARTER 2021

Matt's Market Update

IN THIS REPORT

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Market Review

Global equity markets continued to climb higher in Q1 led by the U.S. markets. As the quarter progressed, optimism over the vaccine rollout (and the positive expected impact on economic growth) along with hopes of more stimulus from the U.S government powered equities higher. The combined impact of continued monetary stimulus from the Federal Reserve along with the prospect for massive growth in fiscal stimulus has brought inflation fears back to the front burner of concerns for investors. Yields across the treasury curve moved sharply higher in Q1 and led to one of the worst quarters for fixed-income investors in recent memory. The key 10-year treasury yield rose from 0.92% at the start of the year to 1.75% at quarter-end. Upward pressure on yields led to a decline of -3.37% for the Bloomberg Barclays Aggregate index. The Morningstar Intermediate Core-Plus Bond category suffered a -2.55% decline. For its part, the Federal Reserve continues to feel that any inflationary pressures on the economy will be temporary and they've given no hint of raising short-term interest rates any time soon.

As you'll note from the below chart, a large reversal in recent market trends took place in Q1 with value strategies outperforming growth significantly across all market caps. The rise in bond yields has been closely correlated with significant outperformance for value stocks. Technology stocks, which powered the growth indexes to massive gains last year, cooled off considerably with the NASDAQ index gaining +2.78%. This lagged well behind the S&P 500 (+6.17%) and the Dow Jones (+8.29%). In addition, small-cap stocks continued their strong momentum from Q4 of last year with a gain of 12.70% for the Russell 2000 index. Similar trends were evident in foreign markets as value funds easily outpaced Growth across all market caps.

INDEX MARKET BAROMETER TRAILING RETURNS

	Q1 2021			1-Year			3-Year		
	Value	Blend	Growth	Value	Blend	Growth	Value	Blend	Growth
Large	10.13	4.72	-0.73	46.12	57.06	55.78	10.15	16.42	21.84
Mid	17.21	8.81	-1.62	74.94	68.33	73.26	8.55	13.89	22.37
Small	21.41	14.76	-0.42	103.31	82.20	81.92	8.97	11.97	18.48

Source: Morningstar Direct

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Random Notes from Q1

In no particular order, here are some of the more interesting data points we came across in Q1:

- In the last 30 years, the best 12-month performance for the S&P 500 occurred over the 1-year period that ended 3/31/21. The S&P 500 gained +56.4% (total return) from 3/31/20 to 3/31/21.
  Source: BTN Research. Written and Copyrighted © 2021 Michael A. Higley

- The share of publicly listed technology companies that make no earnings has risen to 38%, topping the 36% mark from the bubble peak in 2000.
  Source Rosenberg Research

- In terms of asset class highlights, Oil surged higher by +25% in Q1, Gold suffered its worst performance (-10%) since Q1 2016 and Bitcoin surged higher with a gain greater than +100%.
  Source: Bloomberg

- The top 10% of US households (as measured by net worth) own 70% of all assets nationwide as of 12/31/20, i.e., $85.6 trillion out of $122.9 trillion. The bottom 50% of US households own just 2% of all assets as of 12/31/20, i.e., $2.5 trillion out of $122.9 trillion.
  Source: Federal Reserve

- During fiscal year 2020, i.e., the 12 months ending 9/30/20, the US government spent $345 billion for interest payments on the national debt or $945 million a day. 5 years earlier, i.e., fiscal year 2015, the US government spent $223 billion for interest payments on the national debt or $611 million a day.
  Source: Treasury Department

- 2020 was the 10th year in the last 70 years, i.e., 1951-2020, that the US economy had contracted. Our nation's "gross domestic product" (GDP) shrunk by 3.5% last year. Following the 9 previous "down" years, the US economy has rebounded in the next year with positive growth 7 out of 9 times, growing by an average of +3.3% per year for all 9 "bounce back" years.
  Source: Commerce Department

- The 6 bills (totaling $5.6 trillion of aid) passed by Congress to combat the impact of the pandemic in the last 13 months are 1) HR # 6074 ($8.3 billion in March 2020); 2) HR # 6201 ($3.5 billion in March 2020); 3) HR # 748 aka the CARES Act ($2.3 trillion in March 2020); 4) HR # 6312 aka CARES # 2 Act ($484 billion in April 2020); 5) HR # 133 ($900 billion in December 2020); and 6) HR # 1319 aka the American Rescue Plan Act ($1.9 trillion in March 2021).
  Source: Congress

Wealth Management Corner

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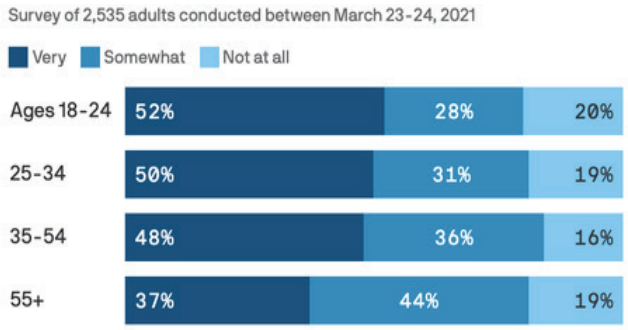
Inflation is Individual

A recently published survey by Civicscience showed that 77% of U.S. residents are worried about higher inflation. The poll surveyed approximately 2,600 respondents and shows that inflation concerns are higher for the younger Americans.[1]

HOW CONCERNED ARE YOU ABOUT INFLATION IN THE U.S.?



Source: CivicScience; Chart: Axios Visuals

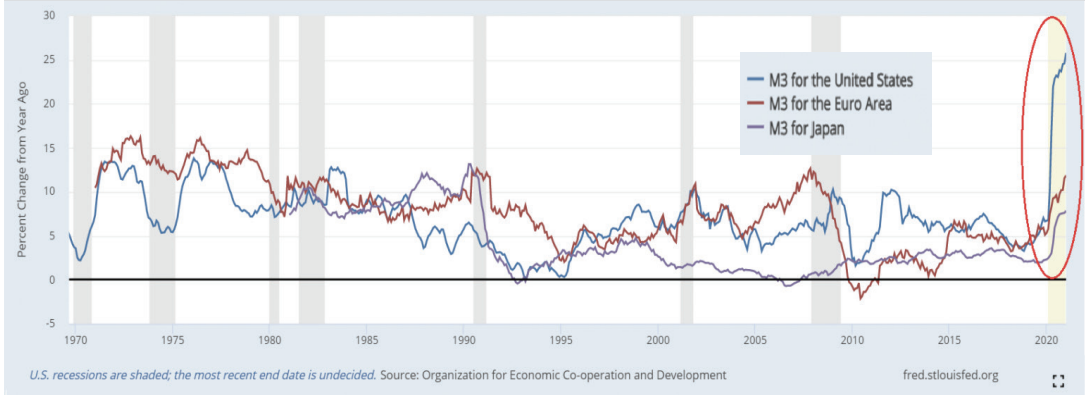
Well, what is inflation? If you use the Merriam-Webster dictionary, it's defined as follows: "*a continuing rise in the general price level usually attributed to an increase in the volume of money and credit relative to available goods and services.*"[2]

Taking this definition at its word, inflation is undoubtedly HERE in the here and now as the amount of US dollars created along with credit levels has gone ballistic. See the chart below for money supply growth. The vertical line is the growth of additional US dollars created in 2020 as measured by the broadest measure of money supply, the M3.[3]

The previous chart is telling us that approximately 25% of US dollars in the financial system were created in 2020. This is historic and daunting by any measurement.

In some economic circles, inflation is defined as a monetary phenomenon and according to the formal definition that sounds about right. Monies true value relies on how much of it is created and what happens to its value over time, i.e., purchasing power, after its creation. It really comes down to how far money stretches after more money is created and injected into the financial system.

M3 MONEY SUPPLY US, ECB, BoJ (YEAR-OVER-YEAR)



Source: Organization for Economic Co-operation and Development

Stepping back for a moment, the reason for the title is to consider what inflation means to you. That's what really matters. Most of us have heard of the Consumer Price Index, or CPI, which has been considered an economic standard measure of inflation for as long as we can remember. Other than being used to peg certain cost of living measurements to it, the CPI really has limited relevance to the individual's spending patterns and their own experienced rate of inflation.

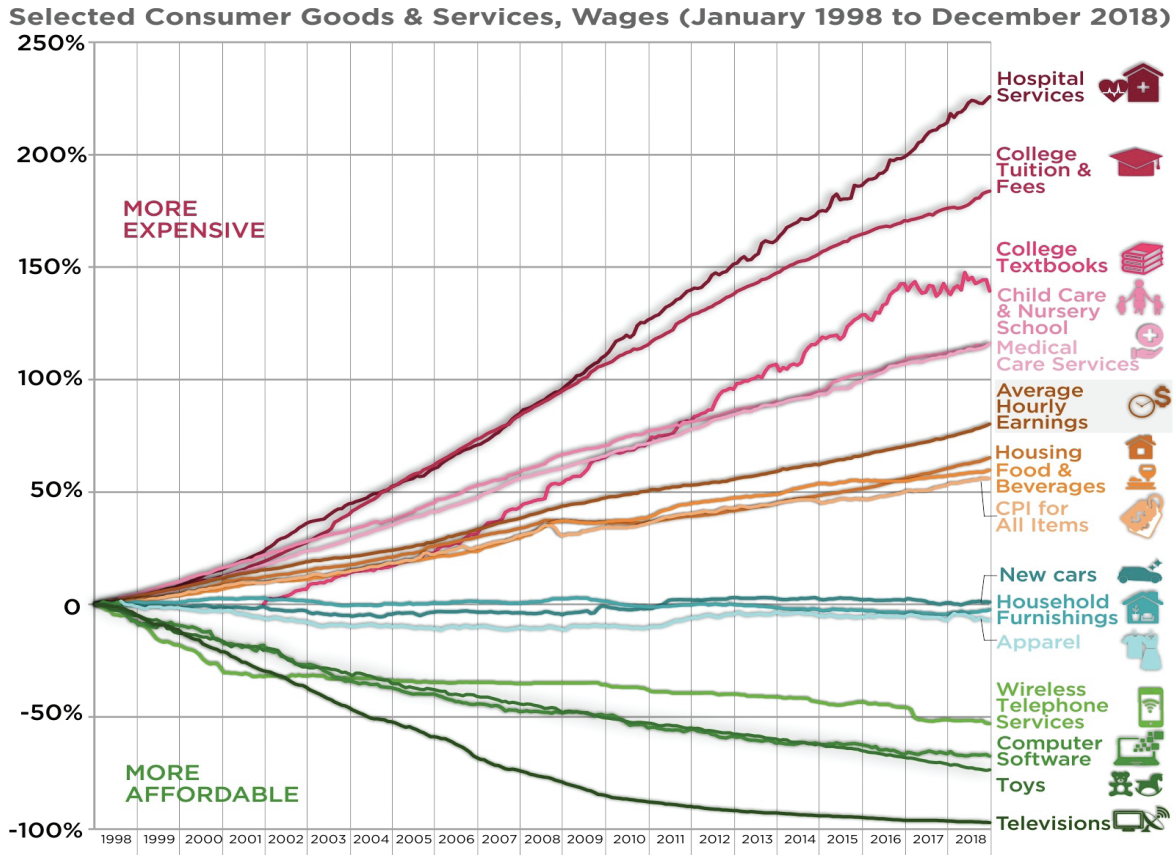
The real question to ask is what do you consume? The answer to that question is how you assess your own inflation. Do you spend most of your US dollars on goods or services? Looking at the somewhat dated chart below, there has been a huge historical difference. Best to just focus on the trajectories over the noted 20-year period.

As the chart shows, the growth in the price for most services, such as medical and education, has definitely surpassed the growth in the cost of goods, such as toys and TVs. This has a lot to do with technological advancements in manufacturing and production, which is in itself deflationary (another future article topic perhaps?) Services are usually powered by human capital and human capital or human labor costs money. Technology doesn't need to pay the rent, we do. Thus, individual perspective is critical.

In summary, the goal of this short article is to get you thinking in terms of your personal inflation rate. Is it hiding or is it in plain sight? Better yet, perhaps it leads to household discussions on budgets and spending.

Of course, please don't hesitate to contact your Sentinel financial planner to discuss further.

20 YEARS OF PRICE CHANGES IN THE U.S.



Source: https://howmuch.net/articles/price-changes-in-usa-in-past-20-years

Our Portfolio Strategy & Allocation Outlook

As we mentioned in our last update, the performance gap between the Growth and Value styles heading into this year had rarely been wider. Morningstar data indicated that only the period of the Dot.com bubble of '99-00 displayed greater dominance for Growth over Value. We also witnessed the Value style starting to gain favor late last year as optimism over the economic recovery was pushing interest higher and leading to good performance across a number of industry sectors. With this in mind, we decided early in Q1 to increase our exposure to our Value equity managers. Considering the considerable lag these strategies have exhibited versus Growth strategies, the prospects for Value look very good assuming a continuation of economic momentum this year.

To fund our increased Value position, we trimmed back on two areas that continue to be under pressure, short-term treasury bonds and gold. The treasury market is understandably under pressure from the recent trend of rising interest rates. Gold's weakness is much more difficult to understand. On one hand, the conditions for gold would hardly seem better as Central Banks around the world are taking coordinated actions to devalue their currencies. Here at home, the U.S. government is printing record amounts of money to fund additional stimulus programs, which should weaken the value of the currency and aid the gold price. However, investors have certainly seen less need for gold in their portfolios as optimism over the vaccine rollout and economic expansion has grown. Rising interest rates for fixed-income securities offer new competition for gold as a safe haven asset. In addition, while hard to measure, the surge in popularity of Bitcoin has certainly stolen some thunder from gold as a portfolio hedge. We continue to think a small position in gold makes sense in a portfolio from both a diversification standpoint and as a hedge against the unknown consequences of this great monetary policy experiment the Federal Reserve is now conducting.

Finally, we're going to break with tradition and offer up some new book recommendations now as opposed to waiting until the end of the year. Going forward, we'll make the picks more timely as they come up. Here are two great choices:

The Price of Tomorrow, by Jeff Booth.
Inflation is understandably in the news this year, but what if our longer-term future is one of deflation? Specifically, deflation brought about by amazing technological progress happening across numerous industries. This technological revolution we're living through has the power to both improve our lives, but it can also have devastating impact on large segments of society that not prepared for these changes.

Bitcoin Billionaires, by Ben Mezrich.
You may remember the movie "The Social Network" which chronicled the founding of Facebook by Mark Zuckerberg. This was a movie based on another Ben Mezrich book. Two brothers, Cameron and Tyler Winklevoss, lost their battle with Zuckerberg for ownership of Facebook, but they eventually found Bitcoin and became billionaires. This fun read takes you through their journey to becoming key figures in the cryptocurrency revolution. The book will also be made into a movie sometime soon.

Please let us know if you'd like to discuss your personal investing and financial planning needs.

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Market Scoreboard

Index Returns (%)	Q1 2021	YTD	1 Year	3 Year	5 Year	10 Year
S&P 500	6.17	6.17	56.35	16.77	16.30	13.91
DJIA	8.29	8.29	53.78	13.60	15.99	13.09
NASDAQ	2.78	2.78	72.04	23.31	22.16	16.89
Russell 2000	12.70	12.70	94.85	14.76	16.36	11.68
MSCI ACWI Ex USA	3.49	3.49	49.41	6.51	9.76	4.93
Barclays Aggregate Bond	-3.37	-3.37	0.71	4.65	3.10	3.44

Source: Morningstar

[1] https://news.bitcoin.com/survey-shows-77-of-americans-are-concerned-about-rising-inflation-prices-for-goods-are-soaring/
[2] https://www.merriam-webster.com/dictionary/inflation
[3] M3 is a measure of the money supply that includes M2 as well as large time deposits, institutional money market funds, short-term repurchase agreements (repo), and larger liquid assets. The M3 measurement includes assets that are less liquid than other components of the money supply and are referred to as "near money," which are more closely related to the finances of larger financial institutions and corporations than to those of small businesses and individuals.

S&P 500 TR: A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the large-cap segment of stock market.

Russell 2000 TR: Consists of the smallest 2000 companies in the Russell 3000 Index, representing approximately 7% of the Russell 3000 total market capitalization often used as a proxy for the small-cap segment of the stock market.

Barcap Aggregate Bond TR: The Barclays Capital Aggregate Bond Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most U.S. traded investment grade bonds are represented. The index includes Treasury securities, Government agency bonds, Mortgage-backed bonds, Corporate bonds, and a small amount of foreign bonds traded in U.S.

MSCI EAFE NR USD: Widely accepted as a benchmark for international stock performance, the EAFE Index is an aggregate of 21 individual country indexes that collectively represent many of the major markets of the world.

DJ US Industrials TR USD: Computed by summing the prices of the stocks of 30 U.S. companies and then dividing that total by an adjusted value--one which has been adjusted over the years to account for the effects of stock splits on the prices of the 30 companies.

NASDAQ: Measures the performance of all issues listed in the Nasdaq Stock Market and is often used as a proxy for the large-cap technology segment of the U.S. stock market.

DJ/UBS Commodity: The DJ-UBSCI is composed of futures contracts on physical commodities and is often used as a proxy for broad-based exposure to the commodity markets.

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